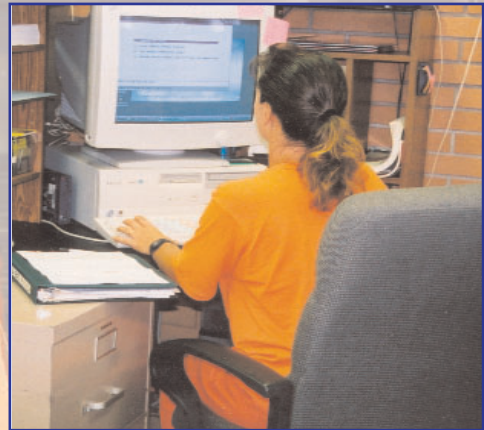


ARIZONA CORRECTIONAL INDUSTRIES

Annual Report

Fiscal Year 2005



*"Practicing on the inside
what works on the outside"*



ARIZONA CORRECTIONAL INDUSTRIES

A DIVISION OF ARIZONA DEPARTMENT OF CORRECTIONS

Dear Director Schriro:

It is my privilege to present the Arizona Correctional Industries Annual Report for Fiscal Year 2005, which by statute must be presented to the Legislature each year.

This year, through the combined efforts of our 85 staff members in partnership with the employees of ADC, and **1,978** inmate workers, ACI achieved record-breaking sales of **\$25.6** million, an increase of **28%** over the prior year. ACI's contribution to the Arizona economy also exceeded previous years with direct and indirect contributions of **\$48** million, an increase of **\$8.4** million over '04. The Auditor General report for FY 04 and previous years stated that the financial statements were "presented fairly, in all material respects".

Inmates assigned to ACI programs worked a total of **2,827,821** hours; each hour representing an opportunity to learn marketable job skills, work habits and financial responsibility.

ACI is committed to the support of Parallel Universe implementation in our unique dual role as a correctional work program and a financially self-sufficient business enterprise to the benefit of the Department of Corrections, the inmates and the State of Arizona.

Sincerely,

Charles Flanagan, Administrator,
Work Force Development



Time for Everyone to Benefit

Under the leadership of Director Schriro, ACI has been incorporated as part of the Work Force Development Bureau. ACI is partnered with Academic Education and Work Based Education to form a logical continuum of literacy and employability acquisition. This forms two-thirds of the literacy, sobriety and employability roadmap to civility and the reduction of relapse, revocation and recidivism, which benefits society, the Arizona Department of Corrections (ADC) and inmates.

The business community is primarily interested in producing profits and we contend that by partnering with ADC, businesses can realize their profit objectives. Additionally, business is interested in trained employees. ADC and ACI can produce a trained workforce with all of the necessary job skills to be successful as they enter the workforce upon reentry into society, which benefits the business community as well.

As a correctional work program, Arizona Correctional Industries (ACI) puts inmates *to work in an environment that closely resembles the work environment on the outside*. This benefits inmates by providing them with the opportunity to become workforce ready and law abiding taxpayers. It also helps create a civil inmate population, focusing on acquiring employability skills while being gainfully employed. Thus, ACI contributes to a safer environment inside the prison.

As a business enterprise, ACI produces a wide range of quality goods and services

for its customers, and generates significant financial benefits for the State of Arizona. ADC is in the process of implementing work-based education that integrates classroom learning and real world work activity. It is our goal that all of our programs will train inmates in current demand occupations, reduce the cost of government by supporting prison complex operations, providing skilled workers to ACI operations and benefiting our communities.

Inmates Frequently, underemployed or un-employed prior to incarceration, many inmates enter the Department of Corrections with few job skills and poor work habits. Through ACI's diverse operations and programs, inmates learn marketable job skills and experience first-hand the work habits, and work ethic required to obtain and maintain employment upon release. In fiscal year 2005, a total of **\$2,121,134** deductions were taken from inmate wages (see chart). This lays the foundation for responsible, self-sustaining behavior and encourages inmates to consider the impact of their crime on their families and victims.

Mission Statement

To create opportunities for inmates to develop marketable job skills, civility and good work habits through successful enterprises that produce quality products and services for our customers.

INMATE WAGE DEDUCTIONS

Distribution by Type

Room and Board*	\$1,458,667
Taxes	\$142,178
Dependent Support	\$30,479
Victim's Compensation	\$122,584
Court Ordered Restitution	\$277,227
Alcohol Abuse and Treatment Fund	\$78,798
SB 1291	\$8,177
Miscellaneous**	\$3,024
Total	\$2,121,134

* Inmate contributions deposited into the State General Fund.

**Includes deductions for disciplinary and compassionate restitution and filing fees.

Institutions In a time of overcrowded prisons and under-funded programs, ACI promotes safety and security by serving daily as an incentive for inmates to engage in model behavior. ACI jobs are earned by inmates whose institutional conduct is good and work and education achievements are noteworthy. ACI maintains high standards of work performance and conduct for inmates assigned to its industries.

Customers ACI customers include Arizona State Agencies, schools, cities, private enterprise, municipalities and civilians. They receive quality goods and services at reasonable prices, allowing them to make more cost-effective use of the taxpayer dollars allocated to them. ACI also contracts with the private sector to provide consistent and reliable workers for businesses that have been unable to meet their work force requirements through the traditional labor market.

State of Arizona ACI contributes to the economic prosperity of the State of Arizona in five distinct ways.

First, ACI is a financially self-sufficient program of the Arizona Department of Corrections. Receiving no financial support from the taxpayers, the program operates entirely on revenues generated from its business activities.

Second, deductions from inmate wages (including taxes, room and board, and family support) relieve taxpayers of some of the expense of incarceration. During fiscal year 2005, inmate wage deductions totaled **\$2,121,134**.

Third, in support of its industries and enterprises, ACI purchases

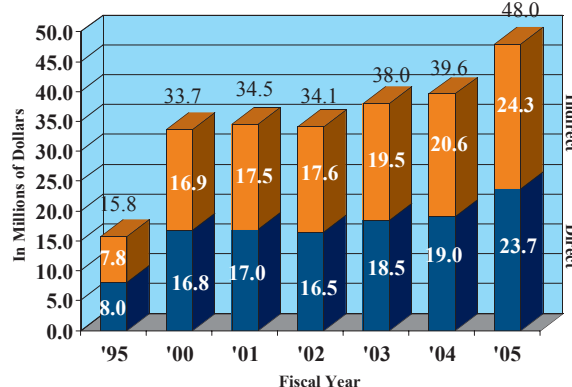


goods and services, employs staff, and creates a demand for goods and services that directly and indirectly benefit the Arizona economy. **During fiscal year 2005, these direct and indirect contributions totaled \$48 million while also creating 403 jobs during that same time (Arizona State University Center for Business Research).** Direct contributions represent expenditures for goods and services, and staff compensation. Indirect contributions represent demand for good and services created by ACI operations and enterprises.

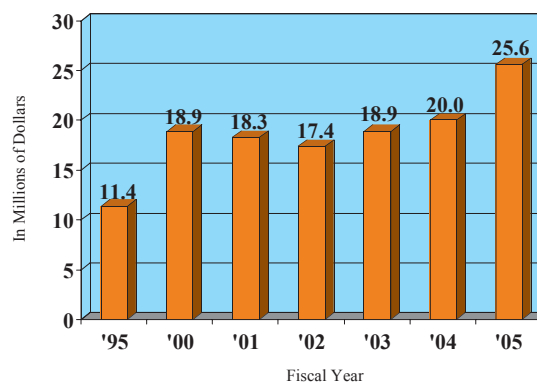
Fourth, ACI contributed **\$500,000** directly to the State General Fund in fiscal year 2005 and an additional **\$1,410,000** to ADC which includes **\$380,000** to start up 13 WBE programs.

Finally, returning law-abiding productive citizens to the community avoids the cost associated with future incarceration.

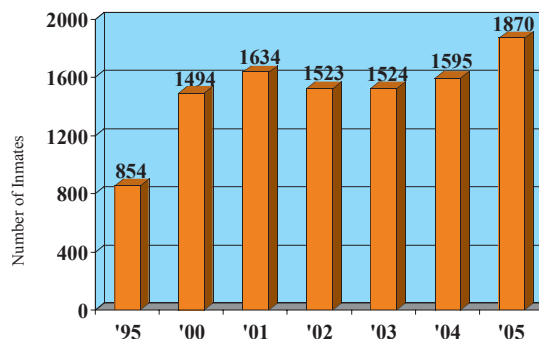
ACI CONTRIBUTIONS TO THE ARIZONA ECONOMY



HISTORY OF REVENUES



INMATES EMPLOYED (Monthly Average)



ACI Prison Industry Enterprises Operations Profile

ACI enterprises consist of two categories of operations: Owned-and-Operated and Public/Private Sector Partnerships. (See list of Operations by Institution)

Owned-and-Operated

These **25** operations are primarily dedicated to saving taxpayer dollars directly by supplying many of the needs of the Arizona State Agencies (including the Arizona Department of Corrections and other public agencies) at a competitive price. Through **25** owned-and-operated enterprises, inmates gain experience in a variety of manufacturing, service and agricultural operations.

Manufacturing: Bakery, Bedding, Furniture, License Plates, Garments, Signs, Wood/Metal Refurbishing, Metal Fabrication and Kit Manufacturing.

Service: Graphic Arts, Data Fulfillment, Installation/Support Service, Office Support, Retail Outlet, Copy Service and Warehousing.

Agriculture: Crop planting, irrigation, maintenance and harvesting.



Private and Public Sector Partnerships, Labor Agreements and PIECP Programs

ACI has **27** partnership agreements providing labor to the private and public sectors.

Private Sector: ACI furnishes workers for private enterprises that are unable to meet their work force requirements through the traditional labor market.

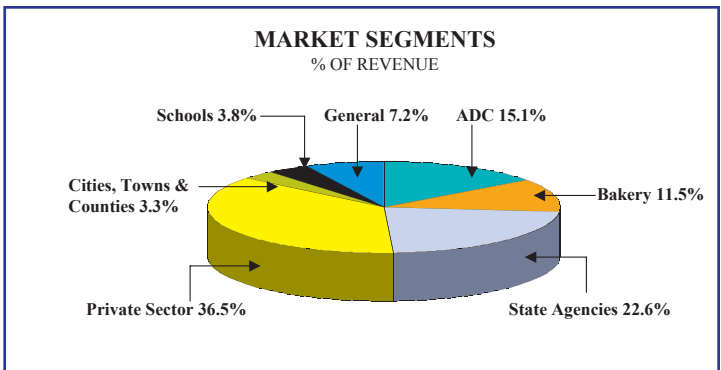
Some of these businesses have established operations within prison walls, while others have operations in the community, with eligible inmates transported to and from the work site.

Public Sector: ACI also enters into contracts with other governmental agencies, such as the Arizona Department of Transportation, Motor Vehicle Division. The use of inmate workers allows government agencies to offer greater services to the community without significant increases in taxpayer support.

Prison Industry Enhancement Certified Program (PIECP's): These 3 programs employ inmates in manufacturing under enabling federal statutes.

Administration

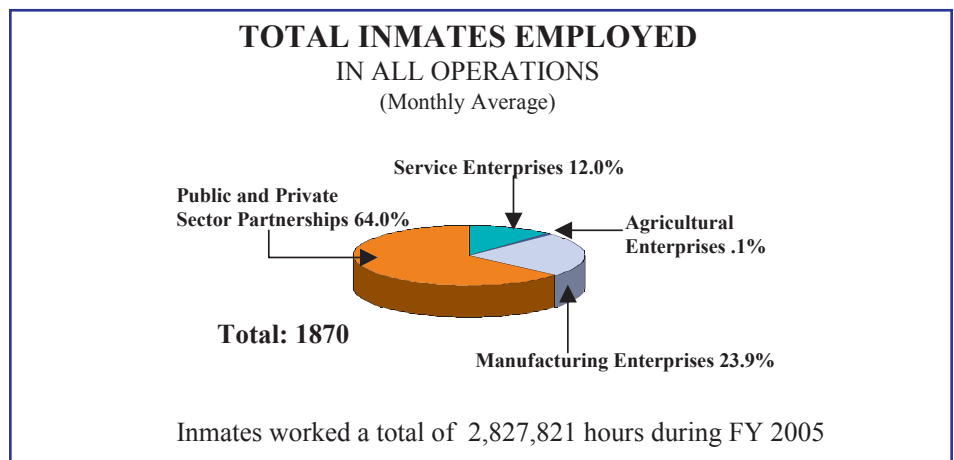
ACI currently employs **69** civilians in support of its activities. ACI averages **\$301,176** in revenue per FTE (NCIA utilized the number **85** and ACI has 101 authorized FTE's), the national average is **\$191,624** in revenue per FTE. ACI maintains extremely low administrative overhead costs.



ACI Quality Initiative

In fiscal year 2005, ACI launched a Quality Initiative as a tool to enhance customer satisfaction and contribute to inmate vocational skills. All staff and inmates were required to complete quality training and planning customized to their particular enterprises. Staff and inmate teams established benchmarks and then created measurable goals and objectives. Although this program is in its infancy, favorable comments have already been received on its accomplishments.

Additionally, the Arizona Quality Alliance recently audited ACI's quality programs, and **ACI is being recognized with the Showcase in Excellence Award for the 2005 Arizona State Quality Awards Program**. The Showcase in Excellence Award recognizes Arizona companies that have implemented a professional quality program throughout their organization. ACI will be formally recognized for their efforts at the State Quality Awards Banquet on December 15, 2005.



ACI OPERATIONS

By Location and Type

Arizona State Prison Complex - Florence

Agriculture	Metal Fabrication Factory
Bedding Factory	Prison Retail Outlet
Central Warehouse Operations	Furniture & Refurbishing Factory
Transportation Division	Commodity/Consumer Products Division
Operations Administration	Industrial Maintenance
Dixon Farms*	License Plate Factory
Eagle Milling Co., Inc.*	Solar Industries*
Eurofresh Bobbin Operations*	

Arizona State Prison Complex - Perryville

Garment Factory	AZ Department of Transportation --
Data Fulfillment Center	Motor Vehicle Division (2 Operations)*
Graphic Arts Division	Televerde (3 Operations)*
Sodexho-Marriott*	Hickman's Egg Ranch (2 Operations)*
Greater Auto Auction*	

Arizona State Prison Complex - Tucson

Sign/Office Products Factory	Farmer's Insurance Company*
AZ Department of Transportation--	Dixon Farms*
Motor Vehicle Division*	

Arizona State Prison Complex - Lewis

Green Acres*	Common Market Equipment Company*
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Arizona State Prison Complex - Winslow

Kit Manufacturing & Re-Upholstery Plant	Eurofresh*
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Arizona State Prison Complex - Douglas

Garment Factory	Southeast Arizona Medical Center*
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Arizona State Prison Complex -Eyman

Bakery Division	Solar Industries (2 Operations)*
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Arizona State Prison Complex - Yuma

Safety Services Co. (2 Operations)*

Arizona State Prison Complex - Safford/Fort Grant

Eurofresh*

Arizona State Prison - Marana

ESB Modular Manufacturing*

Arizona State Prison - Phoenix West

Greater Auto Auction*

ACI Central Administrative Office

Installation/Support Services (3 Teams)	Central Office Operations
Copy Service	

* Public and Private Sector Partnerships

Arizona Correctional Industries Fact Sheet

■ ACI currently maintains 25 Owned and Operated Business enterprises, employing nearly **700** inmates in **6** prisons.

■ ACI manages **27** private sector and governmental labor partnerships with 15 private sector businesses and one governmental agency (ADOT/MVD), employing over 1,000 inmates from **8** prisons.

■ ACI manages **3** Prison Industry Enhancement Certified Programs with **2** private sector companies, which employ more than **100** inmates from **3** prison units.

■ ACI broke all records for productivity, recording sales of **\$25.6** million in FY 05, which represents an incredible increase of **27.79%** over FY 04.

■ The monthly average of **1,870** inmates employed (1,978 positions) by ACI in **57** enterprises produced over **2,827,821** hours of productive work in FY 05, which represents an increase of nearly 300,000 hours above the level in FY 04. It also represents an increase of **275** inmates employed.



■ Inmate deductions totaled **\$2,121,134** in FY **05**, which is an increase over the deductions in FY **04** of over **\$358,000**. Deductions went into the Victim's Compensation Fund, Family Support, Court Ordered Restitution, AATF, SB 1291, Taxes and Room and Board (R&B goes into the General Fund and not back to ADC).

■ ACI has funded the start up of **13** Work Based Education Programs in partnership with the Community Colleges, at a FY 05 cost of **\$380,000**, which provide real employability skills and experience to inmates at 9 prisons.

■ ACI has not substantially grown in staffing size since its inception, and employs up to **101** civilians. In spite of this, productivity has increased more than **4** fold (from approximately \$6 million in annual sales to over **\$25** million which equals a **415%** increase). Additionally, ACI, although smaller in size than comparable correctional agencies, is more productive. The national average revenue per FTE is **\$191,624**, while ACI is producing **\$301,176** average revenue per **85** actual FTE's. This is in spite of not having laws in Arizona mandating that State Agencies purchase goods from ACI, such as are in place in other states.

■ ACI had a long history of producing profits through labor contracts; however, producing significant deficits with its Owned and Operated Business Enterprises. We have instituted significant changes in this regard. In FY 04, ACI reported a deficit of **(\$869,967)** in the Owned and Operated area. In FY 05, we reported a profit in the same area of **\$456,814**. This is an amazing success in any business arena.

■ ACI has initiated a Quality Program, reducing customer complaints, late deliveries, and increasing profitability. We have submitted a nomination for the Showcase in Excellence Awards from the Arizona Quality Alliance, due to our commitment. ACI has subsequently been awarded the Showcase in Excellence Award.

■ Through storm damage which brought our central office roof down in multiple locations and left us with severe flooding damage, ACI was out of our offices for well over 6 weeks, which had an inevitable negative impact on our business. Nevertheless, our dedicated employees pulled together to keep our operations up and running, and are committed to being as successful or more successful than last year.

■ ACI is beginning to explore business opportunities that had not been considered before. We are partnering with our WBE programs such as Graphic Arts, we are expanding our Hydroponics bobbins production, making plastic bags, and in discussion relative expansion into food service, packaging and other areas.

**STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Net Assets
Fund Net Assets - Enterprise Fund
Year Ended June 30, 2004 and 2005**

	<u>2004</u>	<u>2005</u>
Assets		
Current Assets:		
Cash in Bank and on Hand	\$44,491	\$65,711
Cash on Deposit with State Treasurer	3,241,734	3,348,949
Accounts Receivable net	2,509,872	2,594,523
Interest Receivable	14,639	15,682
Inventories	3,299,881	3,728,179
Prepaid Expenses	126,673	140,415
Total Current Assets	<u>9,237,290</u>	<u>9,893,459</u>
Noncurrent assets:		
Capital assets, not being depreciated	692,438	692,438
Capital assets, being depreciated net	1,759,335	1,866,829
Total noncurrent assets	<u>2,451,773</u>	<u>2,559,267</u>
Total Assets	<u>11,689,063</u>	<u>12,452,726</u>
Liabilities		
Current liabilities:		
Accounts Payable	428,789	443,738
Accrued Payroll and Employee Benefits	194,522	211,364
Accrued Compensated Absences	233,376	363,393
Other Accrued Liabilities	540,973	564,081
Total Current Liabilities	<u>1,397,660</u>	<u>1,582,576</u>
Net Assets:		
Invested in capital assets	2,451,773	2,559,767
Unrestricted	7,839,630	8,310,383
Total Net Assets	<u>\$10,291,403</u>	<u>\$10,870,150</u>
Unaudited		

STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Revenues, Expenses and Changes in
Fund Net Assets - Enterprise Fund
Year Ended June 30, 2004 and 2005

	<u>2004</u>	<u>2005</u>
Sales	\$19,928,145	\$25,499,193
Cost of Goods Sold	<u>17,149,328</u>	<u>21,031,342</u>
Gross Profit	<u>2,778,817</u>	<u>4,467,851</u>
Operating Expenses		
Selling	490,166	588,531
General and Administrative	<u>1,894,817</u>	<u>1,966,455</u>
Total Operating Expenses	<u>2,384,983</u>	<u>2,554,986</u>
Operating Income	<u>393,834</u>	<u>1,912,865</u>
Nonoperating Revenues (Expenses):		
Investment Income	72,090	74,405
Net Gain (Loss) on Disposal of Equipment	<u>18,093</u>	<u>(2,937)</u>
Net Nonoperating Revenues	<u>90,183</u>	<u>71,468</u>
Net Income	484,017	1,984,333
Capital Contributions	-	4,500
Transfers out to ADC	-	(910,086)
Transfer out to other state funds	<u>(1,000,000)</u>	<u>(500,000)</u>
Increase (decrease) in net assets	(515,983)	578,747
Total net assets, July 1	<u>10,807,386</u>	<u>10,291,403</u>
Total net assets, June 30	<u>\$10,291,403</u>	<u>\$10,870,150</u>

Unaudited

**STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Cash Flows - Enterprise Fund
Year Ended June 30, 2004 and 2005**

	<u>2004</u>	<u>2005</u>
Cash flows from operating activity:		
Receipts from customers	\$19,220,516	\$ 25,581,994
Payments to suppliers for goods and services	(8,427,784)	(11,437,203)
Payments to employees	(5,155,893)	(5,480,035)
Payments to inmates	<u>(5,671,214)</u>	<u>(6,674,437)</u>
Net cash used for operating expenses	<u>(34,375)</u>	<u>1,990,319</u>
Cash flows from noncapital financing activities:		
Cash transfers to other state funds	<u>(1,000,000)</u>	<u>(1,410,086)</u>
Net cash provided (used) for noncapital financing activities	<u>(1,000,000)</u>	<u>(1,410,086)</u>
Cash flows from capital and related financing activities:		
Proceeds from sale of capital assets	413	(308)
Purchases of capital assets	<u>(226,615)</u>	<u>(530,395)</u>
Net cash provided (used) for capital and related financing activities	<u>(226,202)</u>	<u>(530,703)</u>
Cash flows from investing activities:		
Interest receipts on investments	74,949	74, 405
Contributed capital	<u>-</u>	<u>4,500</u>
Net cash provided (used) by investing activities	<u>74,949</u>	<u>78,905</u>
Net increase (decrease) in cash & cash equivalents	(1,185,628)	128,435
Cash and cash equivalents, July 1	<u>4,471,853</u>	<u>3,286,225</u>
Cash and cash equivalents, June 30	<u><u>\$3,286,225</u></u>	<u><u>\$3,414,660</u></u>

Unaudited

**STATE OF ARIZONA
DEPARTMENT OF CORRECTIONS
ARIZONA CORRECTIONAL INDUSTRIES
Statement of Cash Flows
Year Ended June 30, 2004 and 2005**

Reconcillation of operating income to net cash source/used for operating activities:

	<u>2004</u>	<u>2005</u>
Operating Income (Loss)	\$411,446	\$1,920,496
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	468,522	411,598
Net changes in assets and liabilities:		
Accounts Receivable	(233,990)	(84,651)
Inventories	(623,295)	(428,298)
Prepaid Expenses	(74,443)	(16,193)
Accounts Payable	(495,044)	14,949
Accrued payroll & employee benefits	59,604	146,861
Accrued compensated absences	(14,973)	-
Other accrued liabilities	467,798	25,557
Net cash provided (used) by operating activities	<u><u>\$ (34,375)</u></u>	<u><u>\$1,990,320</u></u>

The following noncash transactions occurred during the year ended June 30, 2004 and 2005:

Building improvements	94,499	332,820
Construction in progress completed	(94,499)	(332,820)
Depreciation expense for discontinued operations	-	-
Accumulated depreciation related to discontinued operations	-	(246)
Capital assets, net of accumulated depreciation	18,093	(2,937)
Gain (Loss) on disposal of equipment	(18,093)	(2,937)
Donated Equipment	-	-
Capital Contributions	-	-

Unaudited



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